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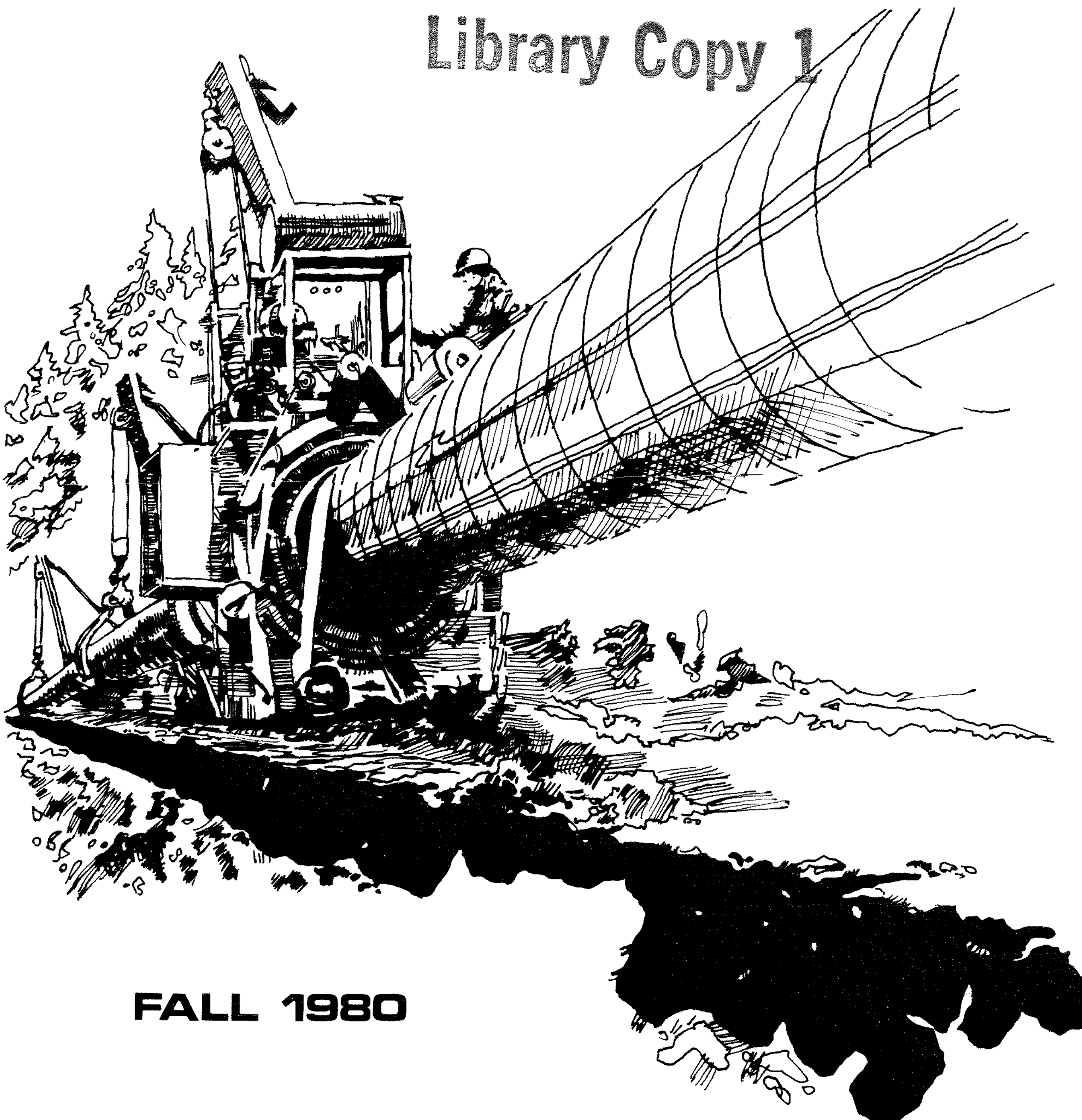

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RESOURCE ALLOCATION-INDUSTRY AND HOUSING

Resource Allocation—Industry and Housing

Public and private policymakers must deal in the 1980's with the problems created by the nation's low investment in capital goods and heavy investment in consumption goods—with all that that means in terms of reduced economic growth. This issue of the *Economic Review* analyzes two aspects of this sectoral resource-allocation theme. The first article discusses the slowdown in U.S. productivity growth as representing a prolonged failure to allocate sufficient resources to capital investment in industry. The second article focuses on policies toward housing and their effect on the behavior of the market under the spur of inflation.

Jack Beebe and Jane Haltmaier note the long-term nature of the slowdown in productivity, with labor productivity rising only about one-third as fast in the 1973-78 period as it did in the 1948-65 period. They also note the serious impact of this slowdown on the nation's living standards—evidenced by the fact that real income per hour would double in 22 years' time at the 1948-65 productivity growth rate, while 58 years would be needed to double real income at the more recent pace of productivity increase.

Studies in the early 1970s attributed much of the deceleration in productivity growth at that time to shifts in employment and output among sectors with different levels of labor efficiency. Indeed, the early postwar shift of workers out of the low-productivity farm sector to higher productivity sectors initially boosted aggregate U.S. productivity growth, but this positive effect waned as the farm share of total employment dropped steeply in recent decades.

Beebe's and Haltmaier's results show that intersectoral labor and output shifts accounted for only a small part of the recent slowdown in labor productivity. "Between the 1948-65 and 1973-78 periods, intersectoral shifts contributed only 0.3 percentage points of the 2.0-percentage-point deceleration in aggregate labor-productivity growth. Moreover, sector-specific declines became evident in nine of twelve industrial sectors, indicating the widespread nature of the productivity slowdown."

The authors show that reduced capital deepening—slower growth of the capital-labor ratios within sectors—was an important factor in the labor-productivity slowdown, accounting for one-third to one-half of the deceleration. On an industry level, this factor was especially important in agriculture, mining, and the large "commercial and other" sector. They also show that the slowdown was not limited to labor productivity, but was evident also in total factor productivity (involving both labor and capital inputs).

Beebe and Haltmaier cite a number of factors that might have contributed to the slowdown in capital investment and hence in productivity. These factors included economic uncertainties, inflation, reduced output growth, tax laws, and government regulations. Consequently, they conclude that "an appropriate policy response would call for a re-examination of governmental policies and other factors that affect capital formation."

With relatively fewer resources allocated recently to industrial capital investment, the question arises regarding the possible overallocation of resources to other sectors. Randall Pozdena suggests that the beneficiary, to some extent, may have been the housing sector. He explores a paradox: housing prices rose relative to most other prices in the economy between 1970 and 1980, prompting officials to argue that housing had become "unaffordable" and that more resources should be directed into the industry, and yet the consumption of housing services continued to rise during this period. Not only did the number of housing units rise faster than the population, but the quality of housing services also rose in terms of floor area and amenities.

In attempting to unravel the paradox, Pozdena argues, "Inflation has been at the root of many of the industry's problems—but this does not mean that inflation has caused a crisis in the form of unaffordable housing or unavailability of rental housing." He argues that housing costs, when properly measured, have fallen relative to other prices despite the rise in housing prices. The widely observed trend away from rental housing, including the conversion of rental housing to owner-occupancy status, meanwhile represents a natural consequence of households' attempts to cope with the combined impact of inflation and tax regulation.

Moreover, he argues that the combination of inflation and special tax treatment tends to alter relative rates of return between housing and other assets, and not simply within housing itself. "Thus, capital that otherwise would have flowed into industrial uses frequently has been attracted to housing instead. Thus the true 'crisis' may be that too much—rather than too little—housing is produced and consumed in our economy."

Pozdena adds that further inflationary distortions occur because of the way that housing is treated in the consumer-price index, which confuses the costs of purchasing housing assets with various costs involved in holding such assets over time. Had an alternative "rental equivalence" measure of housing costs been used in the consumer price index, the index probably would have stood more than eight percent below its reported value in 1979. Thus he concludes, "Considering the myriad public and private programs and contracts which use the CPI as an inflation index, such an overstatement itself has introduced inflation-related distortions into the economy."